

Purchasing Additional Service Credit

Background

This proposal would involve expanding retirement plan provisions allowing the purchase of additional service credit, also known as “air time” (because it is not based on actual service of any kind). Currently, eligible members of the PERS, SERS and TRS Plans 2/3 may, at the time of early or alternate early retirement, purchase up to five years of additional service credit at actuarial cost to offset the required reductions for early and alternate early retirement.

Committee Activity

Presentations:

August 23, 2005 - Executive Committee
October 18, 2005 - Executive Committee

Proposal:

November 15, 2005 - Full Committee
December 13, 2005 - Executive Committee

Recommendation to Legislature

Allow members of PERS, TRS, SERS, LEOFF 1 and WSPRS to purchase up to five years of additional service credit at *normal* retirement for the purpose of increasing their retirement benefit. This service credit would not be membership service and would be used exclusively to provide members with a monthly annuity that is paid in addition to their retirement allowance.

Staff Contact

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Select Committee on Pension Policy

Purchasing Additional Service Credit

(December 20, 2005)

Issue

This proposal would involve expanding retirement plan provisions allowing the purchase of additional service credit, also known as “air time” (due to the fact that it is not based on actual service of any kind). Under such expansion, members of PERS, TRS, SERS, PSERS, LEOFF 1, and WSPRS could purchase up to five years of additional service credit at normal retirement for the purpose of increasing their retirement benefit (as opposed to being limited to purchases made at early retirement to offset the applicable actuarial reduction). A similar provision was adopted for LEOFF 2 during the 2005 legislative session.

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Members Impacted

Expanding the use of additional service credit could conceivably affect all retirement eligible members of PERS, TRS, SERS, PSERS, LEOFF 1, and WSPRS.

Current Situation

As of July 1, 2006, eligible members of the PERS, SERS, and TRS Plans 2/3 may, at the time of retirement, make a one-time purchase of up to five years of additional service credit. The service credit purchased would not need to correspond to any actual service within Washington, or any other retirement system, hence the term “additional service credit.” The service credit is not membership service and cannot be used to qualify for retirement, but it can be used to increase early and alternate early retirement benefits by offsetting the required reductions for early retirement.

Under current law, only Plan 2/3 members who are eligible for early retirement or alternate early retirement may purchase additional service credit. The member pays the full actuarial cost of the service credit with a lump sum payment, eligible rollover, direct rollover, and/or trustee-to-trustee transfer from an eligible retirement plan at the time of retirement.

Currently the Plans 1 do not have provisions that authorize the purchase of additional service credit to offset early retirement reductions because there is no early retirement in the Plans 1. In the Plans 2/3, early retirement is available at age 55 with 20 years of service and alternate early retirement is available at age 55 with 30 years of service.

During the 2005 legislative session the LEOFF 2 Board's legislative proposal concerning additional service credit was successful. This bill differs from the provisions for the Plans 2/3 of PERS, SERS, and TRS in that up to five years of additional service credit is available to those eligible for normal retirement. The service credit purchased can be used to increase the member's benefits, but cannot be used for retirement eligibility. In other words, the member must already be eligible to retire in order to take advantage of this provision. The cost to the member is the actuarial equivalent value of the resulting increase in the member's benefit.

History

The ability to purchase additional service credit was added to the PERS and SERS Plans 2/3 during the 2004 legislative session as Chapter 172, Laws of 2004. The proposal was an outgrowth of the work of the public safety subcommittee that recommended the formation of the Public Safety Employees' Retirement System (PSERS), which becomes effective on July 1, 2006. This benefit was also given an effective date of July 1, 2006. It was intended to address those retirement system members who were not included in PSERS, but who might need to retire early due to stressful or dangerous jobs. Such individuals were thought to be members of either PERS or SERS. It was felt that these additional service credit provisions would provide a vehicle to, in effect, purchase a Plan 2/3 normal retirement when qualifying for early retirement.

The ability to purchase additional service credit was expanded to include the TRS Plans 2/3 by Chapter 65, Laws of 2005. The proposal was forwarded to the Legislature by the SCPP and created consistency with PERS and SERS 2/3. This bill also had an effective date of July 1, 2006. The LEOFF 2 Board's

additional service credit purchase provision (which is described above) was implemented by the Legislature in Chapter 21, Laws of 2005 with an effective date of July 1, 2006.

Proposal

This proposal would expand the ability of members of PERS, SERS, TRS, PSERS, LEOFF 1 and WSPRS to purchase additional service credit as follows:

1. Up to five years of additional service credit could be purchased at normal retirement to increase members' benefits.
2. The service credit purchased would not be used for benefits eligibility.
3. The member would pay the actuarial equivalent value of the resulting increase in the member's benefit.
4. The cost of the service credit may be paid with a lump sum payment, eligible rollover, direct rollover, and/or trustee-to-trustee transfer from an eligible retirement plan at the time of retirement.

Estimated Fiscal Impact

There would be no fiscal impact from this proposal. The OSA assumes that this benefit proposal will not change future retirement behavior in the affected retirement systems. Existing members currently have access to private sector providers that offer products with similar annuities.

Policy Analysis

This proposal would be consistent with the LEOFF 2 legislation that passed in 2005. It would provide the opportunity for members of the various retirement systems to purchase a larger retirement benefit than they would otherwise receive, thus affording them additional flexibility for achieving their retirement goals. This option also promotes benefit adequacy throughout retirement by allowing members to, in effect, purchase a lifetime annuity while saving some of the costs associated with similar product offerings in the private sector. Under this proposal, service credit cannot be used for retirement or benefit eligibility purposes. The service credit is purchased when the member already

qualifies for normal retirement. Thus, the proposal does not alter plan policy with respect to when it is appropriate for members to retire. In that sense, this proposal can fit with a service-based plan design as seen in the Plans 1 as well as an age-based retirement plan design as found in the Plans 2/3.

Additional service credit or "air time" is a less conventional type of service credit, but is available for purchase in other states. The National Council on Teacher Retirement conducted a survey of air time practices in 2004, the results of which are attached at the end of this report. Most of the states allowing this type of service credit require that the member pay the actuarial cost of the increase in the member's benefit.

Executive Committee and SCPP Recommendations

The Executive Committee recommended on August 23, 2005, that this issue be heard before the full SCPP. Staff was directed to prepare a bill draft that was presented to the Executive Committee on October 18, 2005. The Executive Committee recommended that the bill be forwarded to the Full Committee for a Public Hearing and possible Executive Session on November 15, 2005.

The bill was considered and approved by the full SCPP on November 15, 2005. At that time, questions arose about the relationship between additional service credit, or "air time" and other benefit provisions such as the Plan 1 benefit caps. Technical clarification was provided to the Executive Committee on December 13, 2005, to the effect that "air time" is independent of other benefit provisions and is to be used exclusively to provide the member with a monthly annuity that is paid in addition to the member's retirement allowance.

Bill

Attached

Fiscal Impact

(Draft fiscal note attached)

Stakeholder Input

None

BILL REQUEST - CODE REVISER'S OFFICE

BILL REQ. #: Z-0838.2/06 2nd draft

ATTY/TYPIST: LL:ads

BRIEF DESCRIPTION: Permitting members of the public employees' retirement system, the teachers' retirement system, the school employees' retirement system, the public safety employees' retirement system, plan 1 of the law enforcement officers' and fire fighters' retirement system, and the Washington state patrol retirement system to make a one-time purchase of additional service credit.

1 AN ACT Relating to permitting members of the public employees'
2 retirement system, the teachers' retirement system, the school
3 employees' retirement system, the public safety employees' retirement
4 system, plan 1 of the law enforcement officers' and fire fighters'
5 retirement system, and the Washington state patrol retirement system to
6 make a one-time purchase of additional service credit; adding a new
7 section to chapter 41.40 RCW; adding a new section to chapter 41.32
8 RCW; adding a new section to chapter 41.35 RCW; adding a new section to
9 chapter 41.37 RCW; adding a new section to chapter 41.26 RCW; adding a
10 new section to chapter 43.43 RCW; repealing RCW 41.40.713, 41.40.833,
11 41.32.767, 41.32.877, 41.35.473, and 41.35.653; and providing an
12 effective date.

13 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

14 NEW SECTION. **Sec. 1.** A new section is added to chapter 41.40 RCW
15 under the subchapter heading "provisions applicable to plan 1, plan 2,
16 and plan 3" to read as follows:

17 (1) A member eligible to retire under RCW 41.40.180, 41.40.630, or
18 41.40.820 may, at the time of filing a written application for

1 retirement with the department, apply to the department to make a one-
2 time purchase of up to five years of additional service credit.

3 (2) To purchase additional service credit under this section, a
4 member shall pay the actuarial equivalent value of the resulting
5 increase in the member's benefit.

6 (3) Subject to rules adopted by the department, a member purchasing
7 additional service credit under this section may pay all or part of the
8 cost with a lump sum payment, eligible rollover, direct rollover, or
9 trustee-to-trustee transfer from an eligible retirement plan. The
10 department shall adopt rules to ensure that all lump sum payments,
11 rollovers, and transfers comply with the requirements of the internal
12 revenue code and regulations adopted by the internal revenue service.
13 The rules adopted by the department may condition the acceptance of a
14 rollover or transfer from another plan on the receipt of information
15 necessary to enable the department to determine the eligibility of any
16 transferred funds for tax-free rollover treatment or other treatment
17 under federal income tax law.

18 (4) Additional service credit purchased under this section is not
19 membership service and shall be used exclusively to provide the member
20 with a monthly annuity that is paid in addition to the member's
21 retirement allowance.

22 NEW SECTION. **Sec. 2.** A new section is added to chapter 41.32 RCW
23 under the subchapter heading "provisions applicable to plan 1, plan 2,
24 and plan 3" to read as follows:

25 (1) A member eligible to retire under RCW 41.32.480, 41.32.765, or
26 41.32.875 may, at the time of filing a written application for
27 retirement with the department, apply to the department to make a one-
28 time purchase of up to five years of additional service credit.

29 (2) To purchase additional service credit under this section, a
30 member shall pay the actuarial equivalent value of the resulting
31 increase in the member's benefit.

32 (3) Subject to rules adopted by the department, a member purchasing
33 additional service credit under this section may pay all or part of the
34 cost with a lump sum payment, eligible rollover, direct rollover, or
35 trustee-to-trustee transfer from an eligible retirement plan. The
36 department shall adopt rules to ensure that all lump sum payments,
37 rollovers, and transfers comply with the requirements of the internal

revenue code and regulations adopted by the internal revenue service. The rules adopted by the department may condition the acceptance of a rollover or transfer from another plan on the receipt of information necessary to enable the department to determine the eligibility of any transferred funds for tax-free rollover treatment or other treatment under federal income tax law.

(4) Additional service credit purchased under this section is not membership service and shall be used exclusively to provide the member with a monthly annuity that is paid in addition to the member's retirement allowance.

NEW SECTION. **Sec. 3.** A new section is added to chapter 41.35 RCW under the subchapter heading "provisions applicable to plan 2 and plan 3" to read as follows:

(1) A member eligible to retire under RCW 41.35.420 or 41.35.680 may, at the time of filing a written application for retirement with the department, apply to the department to make a one-time purchase of up to five years of additional service credit.

(2) To purchase additional service credit under this section, a member shall pay the actuarial equivalent value of the resulting increase in the member's benefit.

(3) Subject to rules adopted by the department, a member purchasing additional service credit under this section may pay all or part of the cost with a lump sum payment, eligible rollover, direct rollover, or trustee-to-trustee transfer from an eligible retirement plan. The department shall adopt rules to ensure that all lump sum payments, rollovers, and transfers comply with the requirements of the internal revenue code and regulations adopted by the internal revenue service. The rules adopted by the department may condition the acceptance of a rollover or transfer from another plan on the receipt of information necessary to enable the department to determine the eligibility of any transferred funds for tax-free rollover treatment or other treatment under federal income tax law.

(4) Additional service credit purchased under this section is not membership service and shall be used exclusively to provide the member with a monthly annuity that is paid in addition to the member's retirement allowance.

1 NEW SECTION. **Sec. 4.** A new section is added to chapter 41.37 RCW
2 to read as follows:

3 (1) A member eligible to retire under RCW 41.37.210 may, at the
4 time of filing a written application for retirement with the
5 department, apply to the department to make a one-time purchase of up
6 to five years of additional service credit.

7 (2) To purchase additional service credit under this section, a
8 member shall pay the actuarial equivalent value of the resulting
9 increase in the member's benefit.

10 (3) Subject to rules adopted by the department, a member purchasing
11 additional service credit under this section may pay all or part of the
12 cost with a lump sum payment, eligible rollover, direct rollover, or
13 trustee-to-trustee transfer from an eligible retirement plan. The
14 department shall adopt rules to ensure that all lump sum payments,
15 rollovers, and transfers comply with the requirements of the internal
16 revenue code and regulations adopted by the internal revenue service.
17 The rules adopted by the department may condition the acceptance of a
18 rollover or transfer from another plan on the receipt of information
19 necessary to enable the department to determine the eligibility of any
20 transferred funds for tax-free rollover treatment or other treatment
21 under federal income tax law.

22 (4) Additional service credit purchased under this section is not
23 membership service and shall be used exclusively to provide the member
24 with a monthly annuity that is paid in addition to the member's
25 retirement allowance.

26 NEW SECTION. **Sec. 5.** A new section is added to chapter 41.26 RCW
27 under the subchapter heading "plan 1" to read as follows:

28 (1) A member eligible to retire under RCW 41.26.090 may, at the
29 time of filing a written application for retirement with the
30 department, apply to the department to make a one-time purchase of up
31 to five years of additional service credit.

32 (2) To purchase additional service credit under this section, a
33 member shall pay the actuarial equivalent value of the resulting
34 increase in the member's benefit.

35 (3) Subject to rules adopted by the department, a member purchasing
36 additional service credit under this section may pay all or part of the
37 cost with a lump sum payment, eligible rollover, direct rollover, or

1 trustee-to-trustee transfer from an eligible retirement plan. The
2 department shall adopt rules to ensure that all lump sum payments,
3 rollovers, and transfers comply with the requirements of the internal
4 revenue code and regulations adopted by the internal revenue service.
5 The rules adopted by the department may condition the acceptance of a
6 rollover or transfer from another plan on the receipt of information
7 necessary to enable the department to determine the eligibility of any
8 transferred funds for tax-free rollover treatment or other treatment
9 under federal income tax law.

10 (4) Additional service credit purchased under this section is not
11 membership service and shall be used exclusively to provide the member
12 with a monthly annuity that is paid in addition to the member's
13 retirement allowance.

14 NEW SECTION. **Sec. 6.** A new section is added to chapter 43.43 RCW
15 to read as follows:

16 (1) A member eligible to retire under RCW 43.43.250 may, at the
17 time of filing a written application for retirement with the
18 department, apply to the department to make a one-time purchase of up
19 to five years of additional service credit.

20 (2) To purchase additional service credit under this section, a
21 member shall pay the actuarial equivalent value of the resulting
22 increase in the member's benefit.

23 (3) Subject to rules adopted by the department, a member purchasing
24 additional service credit under this section may pay all or part of the
25 cost with a lump sum payment, eligible rollover, direct rollover, or
26 trustee-to-trustee transfer from an eligible retirement plan. The
27 department shall adopt rules to ensure that all lump sum payments,
28 rollovers, and transfers comply with the requirements of the internal
29 revenue code and regulations adopted by the internal revenue service.
30 The rules adopted by the department may condition the acceptance of a
31 rollover or transfer from another plan on the receipt of information
32 necessary to enable the department to determine the eligibility of any
33 transferred funds for tax-free rollover treatment or other treatment
34 under federal income tax law.

35 (4) Additional service credit purchased under this section is not
36 membership service and shall be used exclusively to provide the member

1 with a monthly annuity that is paid in addition to the member's
2 retirement allowance.

3 NEW SECTION. **Sec. 7.** The following acts or parts of acts are each
4 repealed:

5 (1) RCW 41.40.713 (Purchase of additional service credit--Costs--
6 Rules) and 2004 c 172 s 1;

7 (2) RCW 41.40.833 (Purchase of additional service credit--Costs--
8 Rules) and 2004 c 172 s 2;

9 (3) RCW 41.32.767 (Additional service credit purchase--Rules) and
10 2005 c 65 s 1;

11 (4) RCW 41.32.877 (Additional service credit purchase--Rules) and
12 2005 c 65 s 2;

13 (5) RCW 41.35.473 (Purchase of additional service credit--Costs--
14 Rules) and 2004 c 172 s 3; and

15 (6) RCW 41.35.653 (Purchase of additional service credit--Costs--
16 Rules) and 2004 c 172 s 4.

17 NEW SECTION. **Sec. 8.** This act takes effect July 1, 2006.

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DRAFT FISCAL NOTE

REQUEST NO.

RESPONDING AGENCY:	CODE:	DATE:	BILL NUMBER:
Office of the State Actuary	035	12/21/05	Z-0838.2 / Z-0859.2

SUMMARY OF BILL:

This bill impacts all plans within the Teachers' Retirement System (TRS), School Employees' Retirement System (SERS), Public Employees' Retirement System (PERS), Public Safety Employee's Retirement System (PSERS), and Washington State Patrol Retirement System (WSPRS), as well as the Law Enforcement Officers' and Fire Fighters' Retirement System Plan 1 (LEOFF 1) by permitting members who are eligible for normal or unreduced retirement to make a one-time purchase of up to five years of additional service credit. The cost of the additional service credit is the actuarial equivalent value of the resulting increase in the member's benefit. A member may pay all or part of the cost with a lump sum payment, eligible rollover, direct rollover, or trustee-to-trustee transfer from an eligible retirement plan. The bill directs the department of retirement systems to promulgate rules to ensure IRS compliance. The additional service credit purchased under these provisions would not be membership service and would be used exclusively to provide the member with a monthly annuity that is paid in addition to the member's retirement allowance.

Effective Date: July 1, 2006

CURRENT SITUATION:

Under current law, the opportunity to purchase additional service credit (or "air time") is limited. Only TRS, SERS, and PERS Plan 2/3 members who are eligible for **early or alternate early** retirement (age 55 with required service) may purchase up to 5 years of additional service credit at the time of retirement. The member pays the full actuarial cost of the service credit with a lump sum payment, eligible rollover, direct rollover, and/or trustee-to-trustee transfer from an eligible retirement plan at the time of retirement. The service credit is not membership service and cannot be used to qualify the member for early or alternate early retirement; rather, the service credit enhances the benefit and serves as an "offset" to the early retirement reductions in those plans. Under current law, LEOFF Plan 2 members can purchase additional service credit at early, alternate early **or** normal retirement to enhance their benefits.

TRS, SERS, and PERS members who are eligible for **normal or unreduced** retirement do not currently have the option to purchase additional service credit. Also, the option to purchase additional service credit or "air time" is not available to members of LEOFF Plan 1, WSPRS and PSERS. (Note: There are no provisions for early or alternate early retirement in LEOFF 1 or WSPRS). Members of any of these retirement plans could, however, purchase an equivalent annuity through a private sector annuity provider. The cost of the annuity would vary from provider to provider and would be based on the particular annuity product offered. This bill provides the opportunity for members of the affected systems to enhance their normal or unreduced retirement benefits by purchasing additional service credit or "air time" through the Department of Retirement Systems.

MEMBERS IMPACTED:

Any future retiree from TRS, SERS, PERS, PSERS, WSPRS or LEOFF 1 could potentially be impacted by this bill, however, we do not expect a majority of members will choose to purchase additional service credit under this bill. The table below shows the active and terminated vested membership counts for the affected plans as of September 30, 2004.

System	Active	Term Vested
TRS	66,634	6,746
SERS	49,854	4,463
PERS*	156,256	21,031
WSPRS	1,057	39
LEOFF Plan 1	848	7

** Includes members who will transfer to PSERS.*

ASSUMPTIONS:

We have assumed that the member will pay the full "actuarial equivalent value of the resulting increase in the member's benefit" which includes the increase in benefit from additional years of service.

We have further assumed that this benefit proposal will not change future retirement behavior in the affected retirement systems since existing members currently have access to private-sector annuity providers that currently provide similar annuity products. We have also assumed that the full actuarial cost will include the cost of any adverse selection that may develop due to mortality experience and/or interest rate timing by the member.

FISCAL IMPACT:

None.